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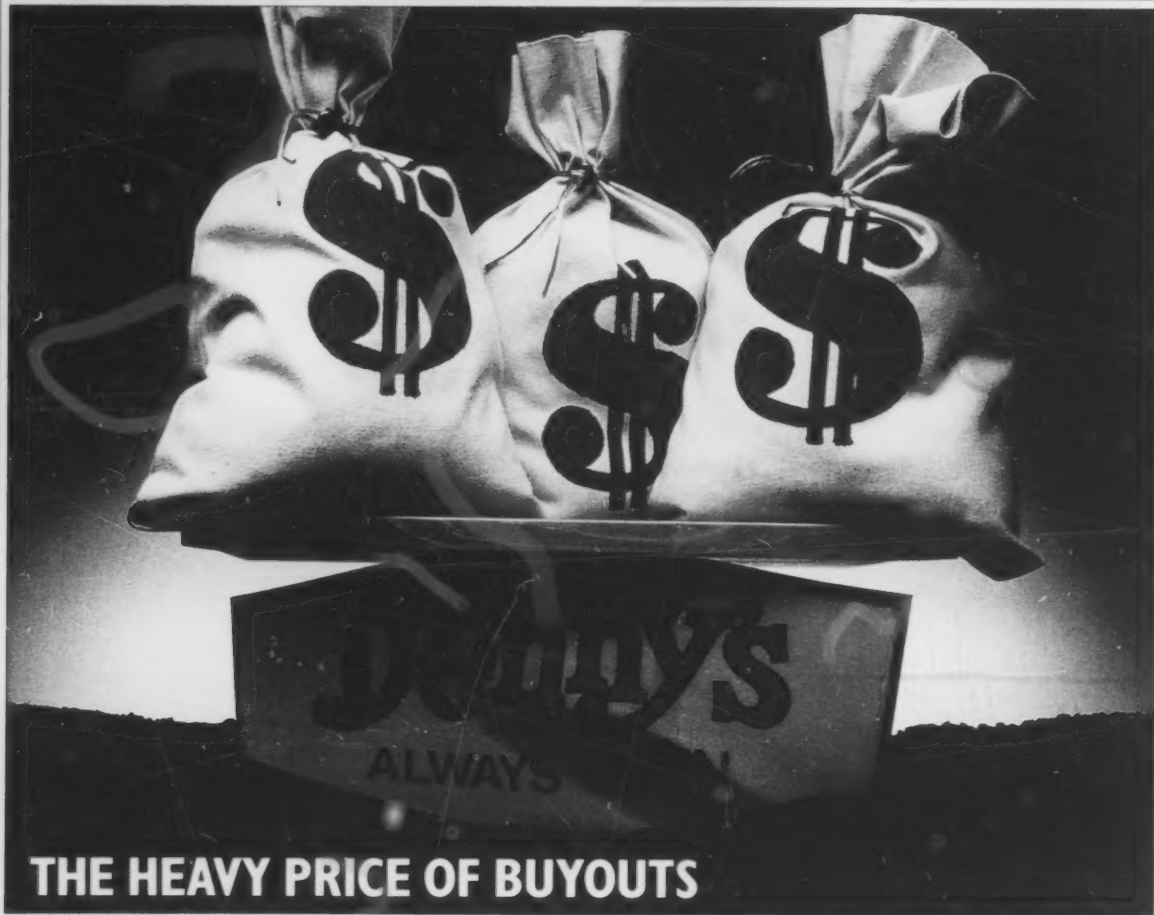
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MARKET SEGMENT REPORT/MEXICAN PAGE 113

Restaurant Business

A BILL PUBLICATION

JULY 1, 1988

**THE HEAVY PRICE OF BUYOUTS**

MERGER MANIA RESHAPES INDUSTRY

PAGE 73

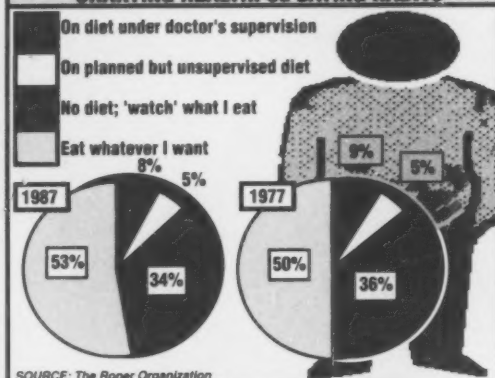
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BUSINESS BAROMETER

The Hard Facts Shaping Our Industry

By Howard Riell

CHARTING HEALTHFUL EATING HABITS



Who Is Dieting, And Why

The propensity to diet has remained notably constant in this country over the last 10 years despite widespread beliefs to the contrary. Is this an indication that operators promoting more healthful menu items are going in the wrong direction? Not necessarily, but it might help explain the many conversions of salad bars to full-fledged food bars offering all sorts of entrees by chains like Rax, Sizzler, and Wendy's, to name a few. On the flip side, however, 41% of those who do diet said they do so for overall health reasons, as opposed to 25% who cited simply the size of their waistlines.

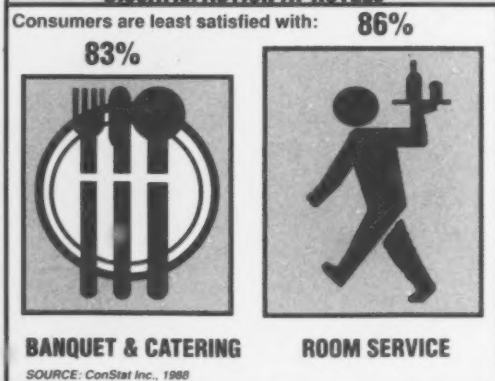
AVERAGE BUSINESS-TRAVELER TABS



The Cost Of Eating Out Of A Suitcase

Business travelers who dined in hotels and motels last year spent an average of \$46.30 on meals in the nation's top 100 business cities, including taxes and tips, according to a study commissioned by *Corporate Travel* magazine. Among the most expensive cities, not surprisingly, were New York (averaging \$82.32 per day), Philadelphia (\$62.92), Honolulu (\$61.46), Boston (\$60.71), and San Francisco (\$57.81). Among the least expensive, and again no surprises: Atlanta (\$43.98), Cleveland (\$42.68), Milwaukee (\$41.86), and Salt Lake City (\$41.33).

DISSATISFACTION AT HOTELS



Poor Grades For Hotel Foodservice

An overwhelming proportion of the 1,700 hotel patrons questioned by ConStat Inc. thought hotels were severely lacking when it came to their foodservice—specifically banquet and catering for special events, and room service. The disturbing figures, then, shed light on both the business and private segments. Where else are hotels failing? Only one out of 10 consumers said they take advantage of frequent-stay programs. Just over half, 57%, recall any hotel advertising in the previous six months. And only 27% felt they experienced a unique or outstanding service or feature during their last stay.

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SPECIAL OFFER

Restaurant Business now has available specially prepared reprints of the **1987 RESTAURANT GROWTH INDEX** and the **1988 MAJOR FORCES IN FRANCHISING**. These annual studies are invaluable reference tools.

The reprints are available for \$5 per copy. Direct orders and inquiries to: Editor Peter Berlinski, *Restaurant Business Magazine*, 633 Third Avenue, New York, NY 10017.



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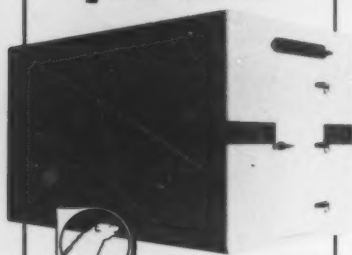


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RESTAURANT BUSINESS/JULY 1, 1988

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RESHAPING THE INDUSTRY

BY KEVIN FARRELL

Merger and acquisition activity, which has remolded the economic landscape of the foodservice industry, will continue to be an important factor in shaping the future of the restaurant industry. In fact, as a result of a confluence of factors, many industry experts believe that merger activity is likely to pick up and continue heavily, at least for the next 18 months.

The reasons are numerous. In an industry confronted by lower valuations, an increasingly difficult business environment, and a raging battle for chain market share, business combinations look better than ever to many companies. They make sense for both acquirers (companies seeking strong new niches or trying to bolster existing operations) and sellers (companies seeking growth financing).

Almost as important, the trend towards disinvestment will also continue, laying the groundwork for management-led leveraged buyouts and spawning conditions for merger and acquisition activity among medium and small-sized companies. Pillsbury has already announced that large pieces of its foodservice empire are on the auction block, and other major players may follow with similar announcements.

NO MORE DRAMATIC ENTRANCE. While some experts disagree with this basic scenario, on one fact they are united: There will be no more dramatic entrances of major non-foodservice industry corporations into the restaurant business. The days of a General Mills or Pillsbury moving from the packaged goods business into foodservice are over. For now, merger and acquisition activity will more likely take place within the foodservice industry itself, as assets are bought, sold, or redeployed in a horizontal rather than vertical manner.

All in all, it appears that mergers

and acquisitions will continue to play an important part in the corporate strategies of foodservice companies. "There's a player for every pattern," claims Malcolm M. Knapp, a New York City-based consultant to the industry.

This stepped-up merger and acquisition activity, however, must be viewed in the context of the overall economy and put in perspective in relation to business conditions in the foodservice industry today. "Unfortunately, the foodservice industry is a tough place to make money these days," laments Jay Fairfield, a restaurant analyst and associate vice president at A.G. Edwards & Sons, St. Louis. "The restaurant industry is in turmoil," adds Bryan C. El-

liott, a chain restaurant analyst with the Robinson Humphrey Company in Atlanta. "And it is out of favor with many investors. The typical restaurant company today is underperforming. There are too many units out there...an oversupply of restaurant seats. That makes it a dangerous environment for the weaker players. Eventually it will work itself out, but for now it is troublesome," says Elliott.

BUY, DON'T BUILD. The fact that the restaurant industry is overbuilt and saturated is not new. What is new is the "buy rather than build" mentality that some experts see sweeping the foodservice industry in the wake of last October's stock market "meltdown."

ILLUSTRATIONS BY GEORGE KANELOUS

Foodmaker's recent purchase of Chi-Chi's puts Jack in the Box's parent squarely in the Mexican dinner-house segment, giving the San Diego-based company more balance in the marketplace.



"The October 19 crash set off a buying binge in this industry," adds Elliott. "When assets can be purchased at low prices, there will of course be buyers."

Since last October 19, a number of major foodservice industry deals have been clinched. Among them:

- TW Services' purchase of Denny's.
- Foodmaker's acquisition of Chi-Chi's.
- Horn and Hardart's deal for International King's Table.
- Anwar Soliman's purchase of Naugles and Del Taco.
- Weatherly's deal for Hamburger Hamlets.
- TPI's purchase of Shoney's South.

In addition, a group of management-led leveraged buyouts have also taken place since the October crash. Many of these deals were completed at lower prices than originally negotiated, in light of the turmoil and the abrupt valuation changes in the capital markets. While some of these deals may have been completed anyway, regardless of the market meltdown, October 19 radically changed the picture for the chain restaurant industry.

Industry observers' opinions on both the short- and long-term impact of October 19 are mixed, however. While some see the crash as responsible for the new wave of merger and acquisition activity, others think current merger mania is merely inherent in this particular cycle of the restaurant industry. Still others feel that restaurant valuations will fall even lower, which will accelerate the current merger activity or set off a new round of acquisitions—both friendly and hostile.

"Before October 19, the market was trading at about 20 times earnings, then it came down to 15 to 16 times earnings, which is still very favorable historically. In light of that kind of movement, people started trying to structure deals again, but there is a good chance of another major decline," cautions Bjorn Hanson, a senior principal for lodging and foodservice consulting for Laventhol & Horwath, the CPA firm based in New York. He sees the possibility of another 250- to 300-point drop in the Dow, which will take the market much longer to recover from. "Restaurants would be hurt very badly in such a situation," he says.

ECONOMIC REALITIES. The future aside, the economic realities of operating restaurant chains in the U.S. today are frightening enough. Consumer spending appears to be headed down-

Unable to juggle all of the foodservice investments it has acquired over the past several years, Pillsbury is taking steps to unload some of its restaurant chains.



ward, competition is increasing daily, the minimum wage is about to take a significant jump, and the industry-wide battle for market share is hotter than ever. "Foodservice companies will buy existing operations in order to enhance market share in certain segments," says David Sher, who runs his own consulting firm and is on the faculty of the School of Hotel Management at Cornell. "What we will see now is a very active, but very selective environment for mergers and acquisitions."

Sher believes that there will continue to be large-scale deals like the Marriott purchase of Saga in 1986, but only if the purpose is to make significant inroads in terms of market share. "After the purchase, Marriott got rid of what they didn't want, and were left with the excellent properties, which is why they did the deal in the first place," says Sher.

"That kind of deal is smart; it fits into an overall sound corporate strategy," he adds. "We'll see more deals like that, where existing foodservice companies shift to other corporate umbrellas where they make sense. But the criteria for a purchase—return on investment—will be tougher than ever in this kind of environment."

Another kind of deal that will most likely be negotiated over the near term is the purchase of small, regional chains that have earned a good customer following. "Smaller, regional chains that

are shopping-center focused and are doing \$1 million to \$1.5 million in average volumes will make good targets," says Hanson of Laventhol & Horwath. "They will be especially attractive to potential suitors if they can be 'chained' easily and in other geographic locations," he adds. Sher agrees with Hanson's assessment: "The new targets will be six- to 15-unit chains with high volumes, good profit margins, and the possibility for expansion. Those kinds of companies would be good candidates for acquisitions or merger activity, or even for going public on their own if the environment for that improved."

"We'll be seeing more of these smaller deals," agrees David L. Epstein, a restaurant specialist and principal with the investment banking firm J.H. Chapman Ltd., Chicago. "In smaller deals, there are more people willing to take a chance, and there is less risk. There will be more activity in the \$5 million to \$10 million and up price range, deals involving companies with excellent concepts, where there is a great deal of incentive to sell, either because the owner wants to get out or the founders want to grow but have

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run out of financing sources." He adds, though, that the environment is tougher than ever for some companies. "Since the market is crowded, there will be a higher failure rate among chains. The smaller ones, without a good concept, or ones that are unable to change quickly enough to suit consumer tastes, will be in trouble."

Medium- and small-sized chains may be forced to look at mergers as the only route for future growth. "Receptivity to restaurant deals in the public markets is extremely low right now," says Stephen A. Rockwell, vice president of Alex. Brown & Sons Inc., based in Baltimore. "Investors don't forget too quickly. Past deals have gone sour. There haven't been enough good restaurant deals for investors to forget

the bad ones." He adds that, partly as a result of the October debacle, public company valuations have declined, and restaurant stocks have been hit hard. "Investment bankers just aren't interested in restaurant deals right now."

As a result, the managers of companies that Rockwell describes as having been good public-market candidates a year ago—those with quality management and a sound concept—will have to look elsewhere for growth financing. Smaller companies in good shape are more attractive than ever to potential acquirers due to lower valuations now. "There are smaller companies out there—I mean smaller than the conglomerates that got into restaurants a decade ago—looking to build portfolios of restaurant companies," says

Knapp. "They're attracted to companies that are doing well in their particular niche. They don't want to get into turnaround situations. They're too risky."

OTHER METHODS. "Wall Street was one way to raise money for expansion," says Richard C. Conti, senior principal and chairman of Laventhol & Horwath restaurant and foodservice consulting group, Chicago. "But that avenue has slowed or ceased, so companies may have to grow more slowly or look to other methods of financing their growth."

Conti and other experts point to venture capital—a market that has, historically, been relatively unenthusiastic about the restaurant industry—and to mergers and acquisitions as routes that

PEPSICO'S PLAN: STAY No. 1

When it comes to the quick-service restaurant segment, PepsiCo's goal is simple: to be number one.

Everything the Purchase, NY-based conglomerate has done in operating its rapidly growing, profit-oriented restaurant group speaks to that. In 1986, the acquisition of Kentucky Fried Chicken (now some 7,500 units strong) made PepsiCo the largest restaurant system in the world with almost 16,500 units at the end of 1987, including Taco Bell and Pizza Hut.

All three of those chains lead their respective operating segments (chicken, Mexican, and pizza), in terms of both sales and units. More significantly, all three offer growth opportunities of unprecedented parallels in terms of new-product development, new-market development, and, subsequently, sales and profitability.

Everything from home delivery to international market development will fuel the growth of all three segment-leading chains, whose domestic

market sales total \$6.7 billion out of a \$56 billion quick-service market.

PepsiCo's growth strategy for its trio of segment leaders is simple: tap into demographic trends and develop products and operating services to meet those needs. That includes everything from Pizza Hut's home delivery, now in 36 states, to KFC's Chicken Littles sandwiches and Taco Bell's testing of new finger foods.

CAREFUL STRATEGY. Backing up all of that has been PepsiCo's carefully developed strategy in mergers and acquisitions. PepsiCo cannot take credit for creating any of its three segment-leading restaurant chains, but it can take credit for identifying the growth leaders it wanted in its foodservice portfolio.

"We're best when we can take something that has been developed and optimize it," says Donovan R. Christopherson, senior vice president-restaurant development, for PepsiCo. "We can do better with our talent on something that's proven. We understand the economics of

standardization, the economics of franchising. We're not good at growing young businesses."

Indeed, not only has PepsiCo been busy assimilating KFC into its restaurant family, it has helped drive unit growth and market penetration for Taco Bell and Pizza Hut by acquiring smaller, regional chains for conversion purposes.

"We're buying and selling restaurants all the time," notes Christopherson. "If they become available, and they're in a market we'd like to have, we bring them in house."

According to PepsiCo, this growth and expansion strategy not only augments the size of its chains but helps avert industry cannibalization because it does not add new units to an already overpopulated restaurant industry universe.

When PepsiCo purchased KFC in 1986, everyone from securities analysts to competitors to consumers figured more would be coming from PepsiCo in terms of foodservice operations.

But first something was going. La Petite Boulangerie, a 147-unit cafe/bakery chain, just did not belong on the same block with KFC, Taco Bell, and Pizza Hut, so PepsiCo sold it in April of 1987.

Now, everyone is waiting for PepsiCo's next move. But will there be one soon? If so, what will it be?

At the time of the KFC acquisition,

make sense for emerging restaurant companies. "There's a lot of money out there looking for the right deals," adds Epstein. "They're willing to put it into the right deals. They have traditionally shied away from restaurants due to the high failure rates, but there are a lot of 'money people' waiting to see how recent deals turn out. If they go all right, we may see a number of others."

The greatest opportunities for acquisitions in the foodservice industry—over both the short and long terms—may come from disinvestment of properties by larger corporations and in management-led leveraged buyouts.

Ten years ago, the big news in the restaurant business was the arrival of the food-packaging conglomerates on the restaurant scene. Pillsbury purchased

Burger King, General Foods gobbled up Burger Chef, Ralston Purina bought Jack in the Box, PepsiCo grabbed Pizza Hut, and it appeared that the day of the foodservice conglomerate had arrived. The strategy behind these deals was diversification and vertical integration of a food distribution company, say analyst, so that one corporation controlled the growing and distribution of food in both the home and away-from-home markets. "They figured that they had the access to the food, so all they had to do was acquire the distribution units and learn to manage multiple units," says Hanson of Laventhol & Horwath.

"But, overall, the performance of foodservice companies under those corporate umbrellas was spotty," says Sher of Cornell. "Gradually, most of

them departed from the industry."

Why? Generally, experts agree that the restaurant mentality doesn't translate well into the corporate milieu. "There are extremely intensive requirements in running a restaurant company," says Roger Lipton, a chain restaurant analyst and managing director for Ladenberg, Thalmann & Co., New York City. "It is a hands-on business, and success or failure is determined at the unit level, not in a corporate headquarters," he notes.

"The winners in this business are the people who are able to create the strongest unit-level execution of quality, service, and cleanliness," adds Elliott of Robinson Humphrey.

"Many of the large companies that
continued on page 84

Michael Jordan, then president of PepsiCo and now president and CEO of PepsiCo Worldwide Foods, said that PepsiCo had not only looked at KFC, but at chains in the hamburger and seafood segments as well.

BURGERS. While nobody is about to grab McDonald's while CEO Michael Quinlan has his way, are Wendy's and Burger King out of the picture for PepsiCo, which does not have an operating wing in the burger segment?

"There's very little they couldn't buy," says Hugh Zurkühlen, an analyst at Salomon Brothers Inc., New York City, who follows the beverage

industry. The idea of PepsiCo acquiring a burger chain intrigued him then as it does now.

The two burger chains, groping for real sales gains, are potentially at-

tractive acquisition targets. "Not knowing the price, you're still buying the second-largest chain, and the big get bigger," Zurkühlen says of Burger King, which Pillsbury is rumored to have on the block. "PepsiCo would like to get another KFC," he adds.

Indeed, a chain like Burger King would offer PepsiCo all the things it seeks in a major foodservice acquisition: optimal distribution outlets and market penetration, and outstanding new-market and new-product development opportunities, including international markets.

GROW PROFITABLY. And as CEO and company chairman D. Wayne Calloway states in the firm's annual report: "Our ability to quickly generate profitable growth from new investments allows us to take full advantage of the significant amounts of cash generated by all three of our businesses. And these businesses provide excellent opportunities to profitably reinvest that cash in existing operations or in closely related acquisitions. Our objective is not merely to grow, but to grow profitably."

But if PepsiCo is looking for another big deal at the moment, it is staying mum on the subject, at least publicly. "We're now probably more interested in real estate than in purchasing other chains," says Christopherson. "But we wouldn't be doing our job if we were not looking at everything."

By adding Kentucky Fried Chicken to its Pizza Hut and Taco Bell holdings, PepsiCo became the largest operator of restaurants in the world, with more than 16,500 units in three systems.



bought into this industry thought that large-scale management expertise would allow them to improve the business, but the restaurant business is very different from the packaged goods business. They thought, incorrectly, that the restaurant business was like others. It isn't," says Hanson.

As a result, companies have started to sell off their restaurant properties. Hanson adds that, now, selling off restaurants "is viewed as getting rid of a headache as well as making a favorable deal. Many of these conglomerates today have compelling reasons to sell off their restaurant properties."

Indeed, Pillsbury has put Godfather's and, reportedly, Steak & Ale, on the auction block. In addition to Pillsbury, only General Mills, with Red Lobster and Olive Garden, and PepsiCo, with Pizza Hut, Kentucky Fried Chicken, and Taco Bell, remain dominant conglomerates in the industry. The other top players, including Marriott, McDonald's, ARA, Dairy Queen, and Wendy's (at least for now) are independent, foodservice-only companies. And industry observers do not expect another rush of corporate purchases of restaurant companies. "Those days are over," says Sher.

OPPORTUNITIES. But the departure of these conglomerates from the restaurant business—or the partial demolition of their foodservice divisions—may provide opportunities for leveraged buyouts. Until a few years ago, leveraged buyouts were very rare, especially in the foodservice business. But, as they grew in popularity in the early 1980s, as

"deconglomeration" became the watchword, the restaurant business became a prime candidate for these kinds of deals. The reason is cash flow. In a leveraged buyout, the management of the division or company borrows heavily, often issuing "junk bonds" against future earnings in order to finance the sale of the company, which then goes private. The only ways to pay down the staggering amounts of debt required to make the purchase are to sell assets or to pay it off out of earnings.

Restaurants are able to do this because the cash flow is a large and constant stream. In addition, restaurant chains can often pare costs significantly and improve margins.

"I wouldn't be surprised to see more leveraged buyout deals in restaurants," says Tom Pratt, a restaurant analyst with Mabon Nugent & Co. in New York City. "There are plenty of people out there dying to lend people the money for this sort of thing."

Others aren't so sure about this positive prognosis for risky LBO activity. Says Hanson of Laventhol & Horwath: "With the future uncertain for restaur-

rants, lenders may be reluctant to take as many chances on management-led LBOs. I think they'll still be done, but at lower levels of debt than a few years ago. You have to be very cautious about taking on high levels of debt in a sensitive environment. I can see 80% to 90% debt levels, and the seller may have to take more debt back, but not the 100% leverage we were seeing two years ago. Deals will be structured differently from now on."

FIGHTING FOR APPROVAL. "Management-led leveraged buyout makes a lot of sense in the foodservice business because it enables managers to take the longer-term view," says Knapp, the New York City consultant. "They won't just be fighting to get Wall Street's approval each quarter." In addition, Knapp says there are pools of money available for these kinds of deals.

There are also a number of current chain restaurant managers who would like to become owners and there are former managers who would like to get back into the game. "There's an old saying in this business: If you've managed restaurants in the past, you'll do it again in the future," laughs Epstein, only half joking.

"There are a lot of people out there with the expertise who are looking to get back into this business. When they hook up with the people with the money, we'll see more leveraged deals." But he cautions that many potential players are waiting to see how some recent LBOs turn out, including Restaurant Association, Carrols, and IHOP. "If they go sour, the whole business could go down."

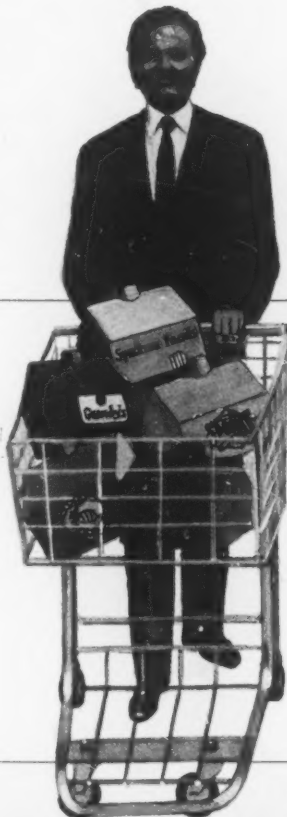
ROBUST OUTLOOK. On the whole, the outlook for merger and acquisition activity in the foodservice industry is robust. But it won't be like it was in the past, with non-foodservice companies coming in to buy restaurant chains at ever-higher multiples. Instead, merger activity will be much more focused, as companies already in the industry seek new niches and larger players continue to diversify.

While there are certainly potential problems looming for the restaurant industry, including soft consumer demand, lower profits, and increased competition, it appears—for now at least—that merger activity will clearly increase.

"Aside from one-unit independents," says Hanson of Laventhol & Horwath, "everyone is a target."

More Merger Mania on page 85

One company's disinvestment is another company's chance for growth, as Anwar Soliman demonstrated when he went shopping with American Restaurant Group—for Marriott's castoffs.



THE MAJOR DEALS

SELECTED FOODSERVICE INDUSTRY TRANSACTIONS, 1984-PRESENT

BUYER/COMPANY	DATE OF ACQUISITION	VALUE OF TRANSACTION \$000,000	REVENUES AT TIME OF PURCHASE \$000,000	COMMENT
ALLECO INC. (Formerly Allegheny Beverage Corp.) Servomation Corp.	5/85	259	495.6 573	Alleco's Servomation acquisition made it the No. 2 contract foodservice concern. An Alleco subsidiary, Service America Corp., was formed (including Servomation and Mackie divisions), then acquired by management in 1987 to help pay debt incurred by Servomation acquisition.
AMERICAN RESTAURANT GROUP Saga Corp.	2/87	300	N/A	Just months after acquiring Saga, Marriott sold it to ARG, a new company headed by former W. R. Grace executive Anwar Soliman. Saga had 343 restaurants, including the Grandy's chain, Stuart Anderson's Black Angus/Cattle Co., Spectrum Foods restaurants, and others. Soliman used this move as a prelude to other acquisitions.
AWR II ACQUISITION CORP. Del Taco Inc. Naugles Inc.	2/88 N/A	Undisclosed Undisclosed	N/A N/A	ARG's Anwar Soliman created a new company, AWR II, for the purpose of acquiring the two Mexican fast-food chains. He planned to combine the two entities (Del Taco's 202 units and Naugles' 171 restaurants) into a more potent competitor to segment leader Taco Bell.
BOB EVANS FARMS INC. Owens Country Sausage Inc.	1/87	15.9	262 N/A	By acquiring this Texas retail operation, Bob Evans Farms, a 186-unit family-restaurant operator based in Ohio, could launch a new chain, Owens Family Restaurants, and develop a Southwest presence. Owens restaurants are slated for initial development in Texas markets.
BOMBAY PALACE RESTAURANTS INC. Lifestyle Restaurants	9/87	5.8	8.6 50	In a stock trade, Bombay, which operates a chain of Indian restaurants, acquired Lifestyle's 16 Beefsteak Charlie's units and franchise rights to 33 others (with total sales of \$50 million for the 49 restaurants). The company plans to upgrade the ailing Beefsteak Charlie's chain, and resume franchising activity on a territorial basis.
CARROLS HOLDING CORP. Carrols Corp.	12/86	109	136.4	With the retirement of chairman and majority owner Herbert N. Slotnick, the Syracuse, NY-based Burger King franchisee was acquired by management. Buyout included \$88 million in cash and assumption of \$21 million of debt. Carrols' 136 Burger Kings made it one of the largest franchisees. However, a \$3.4 million loss was reported in 1986.
CAVALCADE FOODS INC. Furr's Cafeterias Bishop Buffets	12/86	237.5	292	Cavalcade was formed for the purpose of acquiring the two cafeteria chains (133 Furr's units, 35 Bishops) from K Mart Corp. The sale marked K Mart's exit from foodservice, a venture it had not found especially profitable. In Sept. 1987, Furr's/Bishop made a public stock offering; no expansion plans have been announced.
COLLINS FOODS INTERNATIONAL INC. Tenly Enterprises Inc.	7/85	20	395.7 63	Collins, majority owner/franchisor of 548 Sizzler restaurants, acquired Tenly in order to convert Tenly's 80 Rustler steak houses into Sizzler units. The move helped Collins develop a stronger presence in the Northeast, where, at the time, it had operated only 31 Sizzler restaurants.

RB COVER STORY/MERGER MANIA

BUYER/ACQUIREE	DATE OF ACQUISITION	VALUE OF TRANSACTION \$000,000	REVENUES AT TIME OF PURCHASE \$000,000	COMMENT
EQUICOR GROUP LTD. Nathan's Famous Inc.	7/87	19.4	22.9	With only 15 company-owned and 5 franchised units, Nathan's was acquired as an expansion vehicle. Equicor, a newly formed investment group, announced that it will expand Nathan's through franchising. Its projected growth rate is 150 units over the next three years.
FOODMAKER INC. Chi-Chi's Inc.	2/88	230	598.2 289.9	With this move, Foodmaker, parent of 900-unit Jack in the Box, entered the dinner-house market. Though Chi-Chi's is an expansion vehicle, Foodmaker, which went private in a \$450 million LBO in 1985, will have to deal with soft earnings at the 113-unit chain; though 1988 earnings have improved, the chain lost nearly \$5 million in 1987.
HANSON TRUST PLC Imperial Group PLC	4/86	3,836	10,000 7,260	A hostile takeover brought to Hanson Trust, among other things, the troubled Ground Round restaurant chain. Ground Round, with 165 units, is being refurbished and more heavily marketed; several restaurants were closed.
HORN & HARDART CO. International Kings Table	3/88	65	425 100	A tender offer brought H&H about 100 IKT buffet-style cafeterias in the Northwest. The move expanded H&H's presence to a national scope. As with other acquisitions (H&H does not develop its own concepts), H&H's focus will be on improving restaurant operating performance.
IHOP HOLDING CORP. IHOP Corp.	5/87	Undisclosed	264	This represented a leveraged buyout of the 452-unit International House of Pancakes chain. The buyout was led by IHOP CEO Richard Herzer and senior management.
INTEGRA (Formerly Brook Hotel Corp.) Monterey House Inc. Pizza Time Theatre Inc.	8/87 6/85	12.1 5	228.6 N/A 151.8	The 58-unit Monterey House operated under Chapter XI when acquired; Integra planned a \$6 million revamping of the troubled chain. Pizza Time, also under Chapter XI, added 60 units to Integra's 107 ShowBiz Pizza Place units.
INTERNATIONAL DAIRY QUEEN INC. KarmelKorn Shoppes Orange Julius International Inc.	3/86 8/87	Undisclosed 23.5	183.9 2.9 125	DQ's moves significantly broadened its operations. Over 230 KarmelKorn and 725 Orange Julius outlets were added to DQ's nearly 5,000 ice cream stores and 112 Golden Skillet restaurants. QJ franchisees in shopping malls have been encouraged to add DQ/KarmelKorn Treat Centers.
LADBROKE GROUP PLC Hilton International	10/87	1,070	2,617.5 754.5	Months after acquiring Hilton International from Transworld Corp. for \$980 million, Allegis Corp. sold the division (minus U.S. hotel properties) to Ladbroke. With 63 properties, Ladbroke is a leading international hotel chain.
MARRIOTT CORP. Gladieux Corp. Howard Johnson Co. Saga Corp. Service Systems Corp.	1/85 11/85 8/86 2/85	Undisclosed 531 694 Undisclosed	3,524.9 10.5 600 1,254.8 320	Marriott's Gladieux, Saga, and Service Systems acquisitions turned it into the largest foodservice contractor. The HoJo move (Marriott kept 418 restaurants, selling 125 hotels and motor lodges to Prime Motor Inns for \$287 million) provided conversions for Roy Rogers and Big Boy. *Marriott revenues at 8/86: \$4.2 billion.
PANTERA'S CORP. Pizza Inn Inc.	7/87	65	33.7 211.2	Following Pantera's acquisition for \$1.5 million by Concept Development Corp. (CDC), which then changed its own name to Pantera's, the 125-unit chain acquired 255 company-owned Pizza Inns and franchise rights to 472 others. CDC, a former Godfather's franchisee, sold some units and converted the rest into Pantera's.
PARAGON RESTAURANT GROUP Rusty Pelican Restaurants Inc.	11/87	45.9	59.8	Paragon was formed after a \$122.5 million leveraged buyout of VICORP Restaurants Inc.'s 89 specialty restaurants. Dodging a stockholder's takeover attempts, the 21-unit Rusty Pelican found a preferred suitor in Paragon, headed by former VICORP chairman Gordon Miles.

BUYER/ACQUIREE	DATE OF ACQUISITION	VALUE OF TRANSACTION \$000,000	REVENUES AT TIME OF PURCHASE \$000,000	COMMENT
PEPSICO INC. Calny Inc. Kentucky Fried Chicken Corp.** Straw Hat Restaurants Inc.	12/87 10/86 1/87	41.4 841 Undisclosed	9,290.8 68 1,100 N/A	Acquisition of KFC created the nation's largest restaurant operator, and marked RJR/Nabisco's (then KFC's parent) exit from the restaurant business. PepsiCo's Pizza Hut division gained 100 conversion units through the Straw Hat deal; its Taco Bell subsidiary picked up 143 restaurants through its tender offer of Calny, the largest franchisee. *PepsiCo revenues at 10/86: \$8.1 billion.
THE PILLSBURY CO. Diversifoods Inc. Quik Wok Inc.	8/85 6/85	392 Undisclosed	4,670 554.4 4	Diversifoods, a company formed by the 1983 marriage of Chart House and Godfather's Pizza, was Pillsbury's largest Burger King franchisee (377 units). Godfather's had 865 stores, and is today a management takeover target. The 8-unit Quik Wok, slated for expansion, has instead seen closings due to poor results and financial woes at Pillsbury.
RESTAURANT ASSOCIATES INDUSTRIES INC. Acapulco Restaurants Casa Vallarta Office Restaurants	3/86 1/87 11/86	19 8 Undisclosed	163.9 41.5 N/A 10	After acquiring 31 Acapulco y los Arcos restaurants from founder Ray Marshall, RA acquired the 10-unit Casa Vallarta for conversion to Acapulco restaurants. The 6-unit Office chain is an expansion vehicle for RA. In Dec. 1987, RA—which also operates Charlie Brown restaurants and newsstands—itsself was acquired in an \$82 million LBO.
RESTAURANT ENTERPRISES GROUP INC. W. R. Grace & Co. Restaurant Group	12/86	536.7	1,030	This leveraged buyout was led by Norman N. Haberman, former head of W. R. Grace's family restaurant division. The acquisition included 690 family, casual-dining, and dinner-house restaurants, operating under such names as Co-co's, Houlihan's Old Place, Charlie Brown's, Bristol Bar & Grill, and several others. Grace's sale virtually ended its involvement in the restaurant business.
SIS CORP. Sisters International Inc.	4/87	14.5	13.5 N/A	This acquisition marked the exit of Wendy's International from the chicken market. SIS Corp., the largest franchisee of Sister's Chicken & Biscuits restaurants with 20 units, acquired 35 stores from Sister's, a Wendy's subsidiary.
STEVE'S ICE CREAM INC. Swensen's Inc.	12/87	9	N/A 9.3	The acquisition of troubled Swensen's (the company had just lost \$1.3 million on revenues of \$9.3 million) made Steve's the largest ice cream franchisor. Swensen's 340 mostly franchised units were added to Steve's 103 units.
TENNESSEE RESTAURANT CO. Perkins Restaurants Inc.	11/85	Undisclosed	104	The acquisition of Perkins (a Holiday Inns subsidiary) brought to Tennessee and Donald N. Smith (former chairman and CEO of Diversifoods) 103 restaurants and franchise rights to 224 others. The Perkins chain, which raised \$61 million in a public offering in 1986, immediately underwent unit upgrading and menu changes.
TPI ENTERPRISES Shoney's South Inc.	4/88	123	3.2 212.5	Shoney's South, a 250-unit Shoney's franchisee, is said to be the first of many acquisitions TPI plans; the company has over \$200 million in assets. TPI's Shoney's South acquisition, a last-minute move beating a buyout bid by management, occurred after franchisor Shoney's Inc. announced plans to allow further unit development by franchisees.
TW SERVICES INC. DHI Corp. (Denny's)	9/87	858	1,918.1 1,200	Having rejected Marriott's \$854 million bid for Denny's, DHI went to TW Services, a company that was founded to acquire Transworld's Canteen Corp. and Spartan Foods subsidiaries under Transworld's liquidation. DHI itself was the result of a management takeover of Denny's in 1984. The company included 1,191 Denny's and 71 El Pollo Loco restaurants, and a 42% stake in Winchell's Donuts.

*Value of transaction includes cash, stock, and accumulated debt.

Material researched and compiled by Judy Lyon Davis and Ralph Raffio.

Sources: J.H. Chapman Group Ltd., Rosemont, IL; IDD Information Services Inc., New York, NY;

The Food Institute, Fair Lawn, NJ; Restaurant Business.



**Traffic counts were up 48%
over the past five years,
compared to 14% industrywide.**

MEXICAN

BY JACQUE KOCHAK

The Mexican segment continues to be among the strongest in the foodservice industry, but the strength is selective. While some companies prosper, others are feeling the pinch of too much competition.

Overall, according to the National Restaurant Association, sales and traffic counts were up just 4% at Mexican restaurants last year, compared to annual gains in the 6%-to-12% range in earlier years.

BRIGHT PICTURE. Lest the picture appear too bleak, however, consider that traffic counts at Mexican restaurants were up 48% from 1982 to 1987, compared to a 14% average increase at all restaurants.

Mexican restaurants are slowly but steadily increasing their market share, according to the NRA. From 1982 to 1987, Mexican restaurants' share of total traffic rose from 2.8% to 3.6%. The customer base, though small, is expanding.

Success stories vary from one part of the country to another. In the Southwest Tex-Mex belt, innovative new fast-food concepts are attracting more customers than they can serve, while other companies are troubled by too much competition and a depressed economy. The California market is still strong and growing, while the Northeast, viewed longingly by many Mexican operators as virgin territory for expansion, has proven difficult to tap.

"In general, the segment is strong," says Art Becker, vice president of marketing for Cheyenne, WY-based Taco John, the country's second largest Mexican fast-food chain. "This is one of the few segments of fast food that has room to grow geographically. But you can't just go to the Northeast and throw up a building." There are region-



Acapulco Restaurants is noted for a broad menu of authentic Mexican regional cuisine served in a festive family environment.

al differences in taste even within the areas where Mexican food is established, Becker points out.

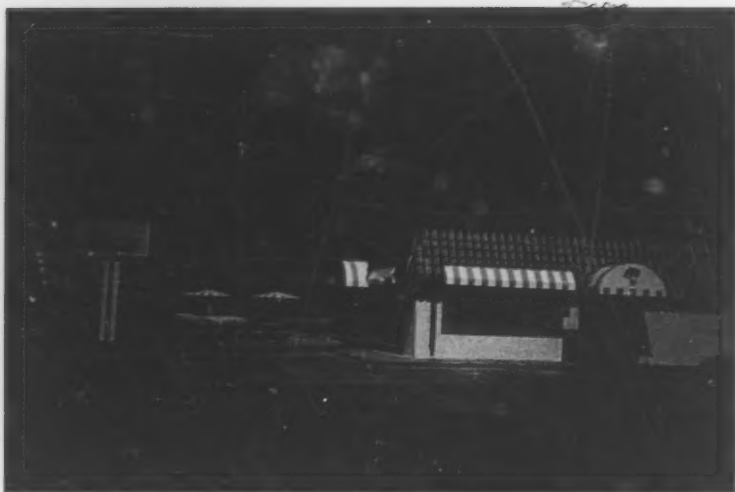
FAST IS FIRST. Fast-food restaurants are definitely the growth leaders in the Mexican segment, with full-service concepts trailing. In 1987, sales and traffic at fast-food Mexican restaurants were up 7% and 5%, respectively, says the NRA. On the other hand,

midscale and upscale Mexican restaurants recorded gains of just 1%.

Growth creates problems. This is intensified for Mexican restaurants in the Southwest, where an oil- and energy-based economy has taken some hard blows.

"The segment is too crowded. There are over 500 Mexican restaurants in

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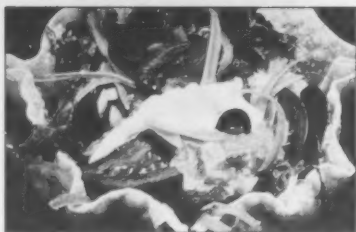


Houston alone," says Roland Laurenzo, president of Ninfa's of Houston, which operates 11 midprice restaurants in Houston and one in Dallas.

INTENSE COMPETITION. A spokesperson for Dallas-based El Chico Corp. agrees that competition is intense in the Southwest. "When you know the number of consumers is not going to grow, you have to gain customers from the competition," she says. "There seems to be a lot of refocusing going on, with top management concentrating on how to improve market share."

Outside of the very crowded Tex-Mex homeland, however, the future may not look so bleak. At least that's the opinion of Vincent Liuzza, president of Cuco's, a small midprice dinnerhouse chain based near New Orleans. "The problems in the midscale segment weren't caused by lack of demand or by customers switching their preference away from Mexican. As all of us get our problems fixed, I think you'll see some things happening."

The upscale portion of the segment is dominated by independents, and they continue to attract a core of new customers who have graduated from mass-market Mexican food. Their emphasis is on a continuing move toward authenticity in food, with operators exploring the wide variety of regional Mexican styles. Restaurants such as La Fogata and Rosa Mexicano in Manhattan, the Frontera Grill in Chicago, and Villa Las Palomas in Orlando are



Top: Taco John's has 425 restaurants; new units seat 60. The chain's Mexican food, like the pictured Super Salsa, is spicier than most.

familiarizing customers with the rich complexities of the cuisine.

One of the most interesting developments in the Mexican segment in recent years is the "patio" concept, which fills a niche somewhere between fast-food and full-service Mexican dining. These concepts, born in Texas, offer authentic, freshly prepared, high-quality Mexican specialties with fast-food-type service but in colorful, festive surroundings more reminiscent of a midscale Mexican restaurant.

They usually offer a limited alcoholic drink menu and low prices. High volumes and 24-hour-a-day service are typical. The two leaders so far are Taco Cabaña and Two Pesos. They are, to say the least, similar.

"They seem like identical concepts, except that one is bright pink and one is bright blue," says Mike Wood, executive vice president for Wichita, KS-

based Taco Tico. "We're all watching them. But the lifestyle is so different down in Texas, who knows how well the concept will go someplace else?"

On the question of whether such concepts can be translated to areas outside the Sunbelt, another operator is optimistic. "Obviously, the concept is geared toward areas where the weather is nice, but the more authentic Mexican food is a plus, as is the atmosphere," says John Corcoran, vice president of finance for San Antonio-based Alfonso's, another patio concept.

DRIVE-THRU-ONLY. Another new development in the Southwestern market is the appearance of kiosk operations that have opened within the last 18 months. Taking their cue from the popular drive-thru-only hamburger kiosks, these operations have names such as Fajita Junction, Cactus Flat, and Fajita Street. They offer limited menus in drive-thru-only buildings.

So far, the kiosks aren't viewed as serious competition by other Mexican fast feeders. "In my opinion, they're dealing in secondary and tertiary locations," says Paula Grissom, vice president of marketing for Dallas-based Taco Bueno. "But the market keeps getting divided up a little more. Everybody's fighting for dollar share."

Adding to the competition is the fact that fast-food operators in other segments have seen the popularity of Mexican food, and are offering some very attractive alternatives. San Diego-based Jack in the Box, for example, offers a Fajita Pita. Dublin, OH-based Wendy's International offers a taco bar as part of its expanded salad bar.

FAST FOOD. Taco Bell, with 2,712 units systemwide, is by far the largest player in the Mexican segment. Owned by PepsiCo, the Irvine, CA-based company posted 1987 sales of \$1.5 billion, with unit volumes averaging \$553,000.

The chain has set its sights high: It aims to establish 4,000 units and systemwide sales of \$4 billion by the end of 1991, only three years away. The goal seems possible: The company has doubled its number of units and tripled systemwide sales in the last five years.

A company spokesperson attributes the steady increase in average unit volumes to upscaling of stores so they are bigger and brighter; to an increased emphasis on service and hospitality; and to the success of Taco Bell's steak



These are some of the menu items that have made Eugene, OR-based Taco Time International a significant force in the West Coast market.

fajitas. Chicken fajitas will be rolled out in August.

Taco Bell has been steadily penetrating regions where Mexican food is not indigenous, particularly the Northeast. In fact, Taco Bell is so large (with 55.5% share of the Mexican fast-food segment) that the company can actually educate wary consumers about its brand of Tex-Mex specialties.

The chain spends an estimated \$60 million on advertising, and has just launched a major new campaign with the theme "Make a Run for the Border." Shot in the Arizona desert, the spots are full of stunts and action and are supposed to convey the idea that when you're hungry for Mexican food, any effort is justified to reach the nearest Taco Bell.

A group of industry veterans is apparently bent on challenging Taco Bell's hegemony. Newport Beach, CA-

based AWR II, which recently acquired Del Taco Inc. and Naugles, is owned by the six principal shareholders, including Anwar Soliman, who also owns the American Restaurant Group (ARG). Soliman is former head of W.R. Grace's restaurant division. ARG owns some 360 restaurants, including Stuart Anderson's, Black Angus, Prego, and The Velvet Turtle.

At the end of March, AWR II acquired two of California's leading Mexican fast-food operations. "We made the acquisitions because we saw the opportunity to become the number-two chain," says John Ghuzzi, vice president of AWR II. "We don't see anyone else stepping up to the plate as a strong competitor against Taco Bell. Both Naugles and Del Taco are quite similar, but were competing with each other behind Taco Bell. We feel there is room for another strong chain, be-

The segment's growth is slowing: Sales and traffic were up 4% in 1987, down from 6% to 12% previously.

cause market penetration has not reached the level of other segments."

Ghuzzi adds that initially Naugles and Del Taco Inc. will continue to operate under two different names. "It's premature to discuss changes," he says. "We haven't made a decision on a name." The two chains will post combined sales of some \$250 million, making AWR II the second largest Mexican fast-food operator in the country in terms of sales. The company has 373 units.

Costa Mesa, CA-based Del Taco Inc. held franchising rights for the Del Taco concept in California. The former Del Taco Corp., now part of W.R. Grace-owned Taco Villa/Del Taco Corp., based in Dallas, holds franchise rights in the rest of the country. Ghuzzi says that AWR II will continue the franchising program now in place, as well as expand with company stores.

Del Taco Inc., with 202 units, differs from 171-unit Naugles (formerly a part of Los Angeles-based Collins Foods International) in that its menu is narrower and its portions are smaller. Also, Naugles is a 24-hour operation.

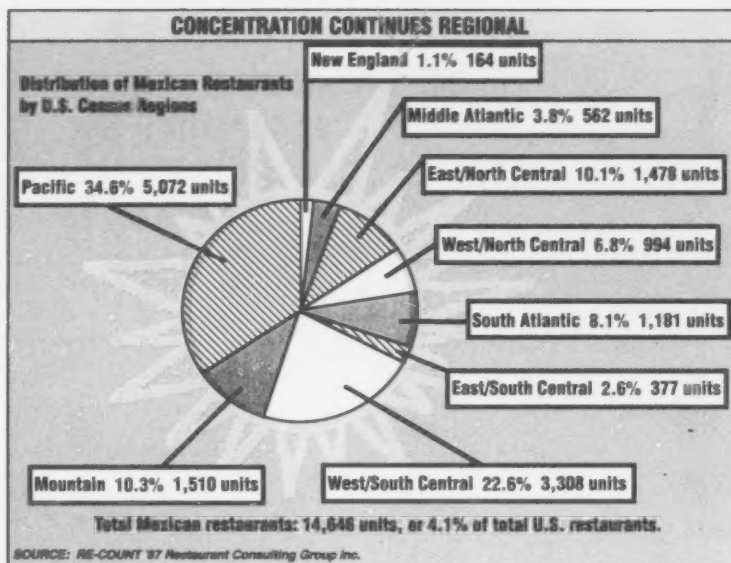
Naugles was acquired by Collins two years ago after Naugles' hasty expansion nearly bankrupted the company. Turnaround moves included trimming unprofitable units, adding a marketing department, and adding to the menu.

MIDWEST PRESENCE. The second largest Mexican fast-food chain in terms of units is Cheyenne, WY-based Taco John, with 425 units, only five of them company-owned. The company should finish 1988 with about 485 units, says Art Becker, vice president of marketing.

Taco John units are located from the West Coast through Illinois and Indi-

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MEXICAN



Mexican units are slowly but steadily increasing their penetration; in five years, share of total traffic rose from 2.8% to 3.6%.

ana, with the largest concentration in the upper Midwest.

Taco John started with little walk-up modular units that have since been discontinued. Newer units are 40 ft. x 40 ft. and seat 60 people comfortably. For the newer units, average unit volume is \$350,000, says Becker. Systemwide sales in 1987 reached \$110 million.

Taco John is gradually expanding its menu, recently adding a dessert item called a *churro* as well as a smothered burrito. Two more products are in test.

Taco John's point of differentiation from other Mexican fast-food outlets is that the sauces are considerably spicier than the norm. "That eliminates some customers, but the people who like us, like us a lot," says Becker.

Taco John is also different from many fast feeders in that the company successfully ventures into very small towns. For example, it has units in Hardin, MT, population 4,000, and Yates, SD, population 3,000.

A significant force in the Mexican fast-food market on the West Coast is Eugene, OR-based Taco Time International, with 250 units, all but 19 franchised. An aggressive expansion program in recent years has taken the company beyond its regional base into Canada, Venezuela, Japan, and En-

gland. Now the company's sights are set on east of the Mississippi. Some 23 to 25 units will open in 1988.

Del Taco Corp., which retains rights to expand the Del Taco concept outside of California, is controlled by Dallas-based Taco Villa Inc., a public company 80% owned by New York City-based W.R. Grace & Co. The 140 units are located mainly in Texas and the Southeast and operate in tandem with 45 Taco Villas in Southern markets.

Both concepts share some of the same menu items, though the Del Taco menu has more elaborate entrees such as enchiladas, chimichangas, and combination plates. Taco Villa favors tacos and other hand-held items. However, there is enough similarity to allow efficiency in marketing and advertising.

Wichita, KS-based Taco Tico, with 115 units in the Midwest, is continuing a remodeling program and adding drive-thrus to units. Some 42 units are franchised, and 73 are company owned, with unit volumes averaging \$330,000. Sales in 1987 reached \$36 million.

The company will be adding two to four company units this year as well as four to six franchised stores.

Dallas-based Taco Bueno, a subsidiary of Unigate Restaurants, operates 108 company-owned restaurants primarily in Oklahoma and Texas. Units are clustered especially heavily in the Dallas/Ft. Worth, Oklahoma City, and Tulsa markets.

Taco Bueno's 2,400-sq.-ft. units typically seat 92 people. Taco Bueno is similar to other fast-food Mexican chains, with a menu featuring beef tacos and burritos as well as grilled chicken and steak fajitas, fajita platters, and guacamole salad. Emphasis is on fresh, high-quality ingredients.

New menu items include chicken fajita nachos. In 1987, Taco Bueno introduced MexiDips & Chips, which accounts for more than 8% of sales.

While Taco Bueno at this point is strictly regional, vice president of marketing Grissom calls the company a strong competitor of giant Taco Bell in the markets where they meet head-on. "According to our research, customers prefer our taste," she says. "But you sure can't ignore Taco Bell."

Taco Bueno's advertising and marketing budget is a mere \$3 to \$4 mil-

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CHART BY SHARI FANG

MEXICAN



Fast-food restaurants are the growth leaders in the Mexican segment, with full-service concepts trailing behind.

Metairie, LA-based Cuco's has improved platter presentations and added shrimp fajitas, shrimp nachos, and chicken salad.

lion, compared to Taco Bell's \$60 million, but the company recently broke a new advertising campaign aimed directly at Taco Bell's competition.

The company has also just introduced a new building design in Ft. Worth. The prototype has an expanded interior to accommodate a larger seating area, as well as a new color scheme of light peach, teal blue, and deep rose. Other interior features include a new menu board design and expanded product merchandising, a skylight in the dining area, a salsa bar, new uniforms, additional cash registers, and a more efficient kitchen. The exterior sports rose-colored neon accents and outdoor patio seating.

PATIO CONCEPTS. The largest of the new patio concepts is Houston-based Two Pesos, a public company now operating 22 company units and two franchised units. New units are opening monthly, and management hopes to have 30 to 40 open by March 31, 1989, the end of Two Pesos' fiscal year.

Two Pesos buildings are bright blue, with some seating indoors, some on an open-air patio, and some in a dining room sheathed by garage-style doors that can be opened weather permitting.

Customers place their orders at a counter, then take their food to a condiment bar. Beverages are self-service.

Mainstays of the menu are the trademark homemade flour tortillas, sizzling fajitas, Mexican rice, and "borracho" beans, says director of marketing Chuck Herrera.

Another trademark is 99¢ margaritas, but alcohol is provided only as a complement to food, says Herrera. Beer, wine, and margaritas account for about 10% of sales.

Two Pesos is the first patio concept to venture outside of Texas, where mild winter weather makes a year-round patio viable. Restaurants were to have opened by press time in Oklahoma, Arizona, and Atlanta, and two new franchisees were to announce building plans in Virginia and Denver.

The weather outside the Sunbelt is definitely a concern for Dallas-based Chili's, which last year signed a joint venture agreement to expand another

patio concept, San Antonio-based Taco Cabaña. "It doesn't take a rocket scientist to figure out that bad weather can hurt the sales at a patio concept," says Ron McDougall, president of Chili's.

So far, Chili's has built three Taco Cabañas in the Dallas/Ft. Worth market. "We're still in a test mode," says McDougall. "We've had positive comments on the food and ambience, but a third to half of the seating is outside, and our concern remains the weather."

Chili's joint venture with Taco Cabaña gives Chili's world territorial rights, not including South Texas, Mexico, Southern California, Tucson, and Washington, DC—areas retained by Taco Cabaña.

Taco Cabaña was founded in 1978 by members of the large Stehling family. The brothers and sisters later split up, with six of them going on to found another similar concept in San Antonio called TaCasita.

Ten company-owned Taco Cabaña units are open, in San Antonio, Dallas, and Austin. Average sales are \$2.5 million per unit. The units also feature double-drive-thru windows that generate between 30% and 40% of business. Average check is \$4.50.

Taco Cabaña and Two Pesos units are virtually identical except that Two Pesos' exteriors are blue and Taco Cabaña's are pink. That similarity has been the cause of lawsuits, with Chili's executives alleging that Two Pesos copied the Taco Cabaña concept.

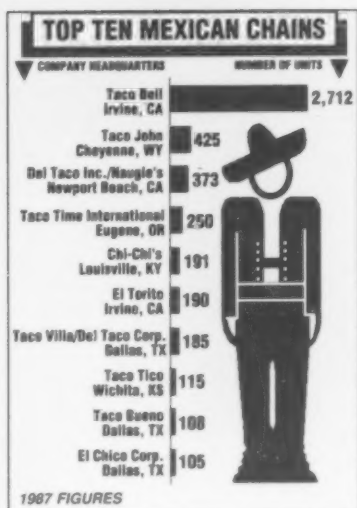
TaCasita is very similar to Taco Cabaña and Two Pesos in appearance. Five units are open, two in San Antonio, two in Austin, and one in Houston. Again, the mainstay of the menu is beef fajitas made from skirt steak, as well as chicken fajitas and flour tortillas made fresh daily.

Principal owner Mike Stehling admits that if TaCasita moves out of the Texas market some of the authentic food will undoubtedly be modified. But for now the broad, authentic menu keeps customers satisfied, and average unit volumes of about \$2.5 million keep the owners satisfied.

Yet another of the popular patio concepts is Alfonso's, with 13 company-owned restaurants in the San Antonio market. Two more units are under construction.

The first unit opened in 1982 on San
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Antonio's south side, and was in direct competition with Taco Bell. All foods are prepared from scratch and served in a casual, upbeat atmosphere. Customers can add spices from a free-standing condiment bar. Margaritas are available along with domestic beers on tap and iced bottled beers from Mexico.

Alfonso's is now embarking on a re-decorating program, with an emphasis on brighter colors, neon lighting, and more landscaping around the patio. Management is also contemplating changing the name to something more distinctly indicative of Mexican food. "Alfonso's could be Italian in another kind of market," Corcoran points out.

FULL-SERVICE RESTAURANTS. A re-sounding success story among mid-price Mexican restaurants is Louisville-based Chi-Chi's Inc., which has undergone a successful turnaround under the leadership of Hal W. Smith, brought on as chairman and chief executive officer a little over two years ago.

In fact, a revitalized Chi-Chi's became an attractive takeover target, and the company was recently acquired by San Diego-based Foodmaker Inc., operator of the Jack in the Box hamburger chain.

Chi-Chi's, with 191 units, had expanded too rapidly, and sales had been sliding for three years. In addition, the company was troubled by high management turnover. All this was going on at a time when many midprice restaurants were troubled by saturated markets and soft sales. The Mexican segment had seemed to be wide open, but in some areas customers didn't warm up to Mexican food as quickly as expected, and in other, more mature markets, customers were too sophisticated for Chi-Chi's comparatively bland Sonoran-style offerings.

Smith traced unit-sales declines to inconsistent customer satisfaction, made worse by revolving-door unit management. He promptly improved compensation, reduced excessive work hours, and established a new training program. Improved recruiting and hiring policies are bringing in more qualified candidates. Smith also moved to improve profitability by writing off marginal units, cutting administrative staffing and overhead, and developing a smaller prototype unit.

The menu has been redesigned with

more color and brighter graphics. The company has also upgraded plate presentation and improved menu selections, with new entrees including pork fajitas. Chi-Chi's relies heavily on its fajitas line, called by the trademarked name "Chajitas." The line includes chicken, beef, and shrimp fajitas, served on a sizzling platter and folded into warm flour tortillas, then topped with cheese, guacamole, sour cream, and *pico de gallo* relish. Chajitas account for about 19% of Chi-Chi's sales.

The company also spent an average of \$45,000 per store on exterior and interior improvements to remodel all company stores. The restaurants now are more colorful and less cluttered, with large, bright murals greeting customers at entrances and in the bar and dining rooms.

NEW CONCEPTS. With Chi-Chi's renewed success has come an interest in testing new Mexican concepts, including El Pronto walk-up mall units featuring a scaled-down Chi-Chi's menu. Also new for Chi-Chi's is Papanada's Border Cafe, a Mexican dinner house with some American menu items, designed specifically for the Southeast and South Central U.S. A reformulated concept and new name help prevent public confusion with Chi-Chi's franchises that failed in Georgia and the Carolinas.

The other new concept is called Chajitas, which is similar in some respects to the patio concepts. The fast-food Chajitas features a display mesquite grill, alcoholic beverages, and attractive surroundings as well as a limited menu, relatively low prices, and fast service.

Chi-Chi's major competitor in the dinner-house segment is Irvine, CA-based El Torito. The chain is owned by Restaurant Enterprises Group Inc., the management-owned company that bought all of New York City-based W.R. Grace Co.'s full-service restaurants. Restaurant Enterprises Group Inc. also owns Kansas City-based Gilbert/Robinson Inc.

El Torito operates 190 restaurants under a variety of names, including El Torito, Casa Gallardo, Casa Maria, Tequila Willy's, and Whc Song & Larry's.

The company has been very quiet about its activities since its acquisition by Restaurant Enterprises Group.

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Taco Bueno features many variations on the popular fajitas, including this new item, Chicken Fajita Nachos.

"We make a policy of keeping our business affairs private," notes executive vice president Mike Casey.

TAILORING. One regional Mexican dinner-house chain, Dallas-based El Chico Corp., is pursuing a policy of adapting restaurants to individual markets in order to build a competitive advantage. For example, the menu at Cuellar's Cafe was changed five times in response to customers' suggestions about spiciness and product mix. Cuellar's Cafe is a 270-seat theme restaurant operated by El Chico.

El Chico operates 33 franchised and 65 company-owned restaurants in Texas, Louisiana, and Oklahoma. The company has closed a few unprofitable units, but is planning to expand in the South and the Southeast by the end of fiscal 1988-1989. Last year, El Chico implemented a program of aggressive cost-cutting following an unprofitable fiscal year ending in May 1987. This year, however, the company is back to showing a profit.

Another midprice Mexican restaurant chain that has suffered in a soft market is Houston-based Monterey House. The 58-unit company is now owned by Integra, formerly Brock Ho-

tel Corp., which bought it out of bankruptcy. Units are located in Texas and Oklahoma, with 60% clustered in the Houston area.

The company is experienced in turning around floundering restaurant chains; a few years ago, Brock took on the challenge of resurrecting stricken ShowBiz Pizza Places. "We were successful enough with turning ShowBiz around that the time seemed right to take on something else," says Dick Huston, who is a Brock vice president of marketing involved in activities for both ShowBiz and Monterey House.

Huston says that sales trends are now positive after three years in the red. The going hasn't been easy, however. Huston says that Brock Hotel Corp. did quite a bit of research before making the acquisition, and found that unit sales levels were half what they had been four or five years ago, down to a little more than \$400,000 annually. "There had been significant sales deterioration for a while, and we knew that things would get worse before they got better," he says.

Ninfa's of Houston is experimenting with a fajita delivery service.

Integra's strategy is to hold on to Monterey House's old core of loyal customers, and lure back the "rejecters," those who had tried the restaurants and categorized the food as "bland, microwaved, and precooked," says Huston.

"We owned Monterey House for almost nine months before we started marketing to the public," he adds. "We think we've 'fixed' the food, but to characterize this as a smooth transition would be a lie. For example, Monterey House used to hide a little piece of caramel candy in the chips. We stopped doing that, and we got 500 or 600 comment cards saying 'What have you done?'"

Huston is firm that Monterey House is not trying to reposition, or "jump out of its niche," as he phrases it. "Monterey House will never be on the leading edge," he says. "We're not positioned as a gourmet restaurant, or as a trend-setting concept. We appeal to Middle America, the people who go out for regular lunches and Tuesday night dinners with the family."

The company's new television advertising emphasizes that Monterey House is the same, but better. Television spots highlight beautiful food shots, showing a customer who is unable to decide what to choose from all the new entrees on Monterey House's menu.

Integra is also remodeling restaurants, punching in skylights to lighten dining rooms, and adding lots of plants and Mexican color and artifacts.

Acapulco Mexican Restaurants, owned by New York City-based Restaurant Associates, operates 41 company-owned restaurants in California,



Oregon, and Washington. The chain grew substantially last year with the acquisition of eight Casa Vallarta Restaurants and two La Villa Taxco Restaurants. An additional one or two restaurants will be acquired this year, says Grant Beresford, promotions coordinator.

Acapulco Restaurants, noted for a broad menu of authentic Mexican regional cuisine served in a festive family environment, has seen unit sales hold steady at about \$1.75 million annually.

TRAVELING FAJITAS. With 11 midprice restaurants in Houston and one in Dallas, Ninfa's of Houston is successfully experimenting with a fajita delivery service from three restaurants, with plans to expand the service to all units. Restaurants deliver chicken or beef fajitas along with side dishes such as chili con queso, beans, and flour tortillas to homes within 10 minutes' driving time of units.

Fajitas are sold by the pound and come with red and green sauce, chips, onions, and *pico de gallo*. Price is \$10.95 a pound, and the service is so successful that sales at one unit have increased by 15%, at another by 10%, and at a third by 8%.

Fajita delivery was relatively inexpensive to initiate, says president Roland Lorenzo, because drivers use their own cars. The service was advertised by means of doorhangers and direct mail that zeroed in on nearby neighborhoods.

Metairie, LA-based Cuco's is a mid-price Mexican chain that has successfully negotiated rough waters and is showing its third consecutive year of increased comparable unit sales after losing money. Cuco's operates 23 units, nine of them company-owned, most of them in economically hard-hit Louisiana.

For the last year and a half, Cuco's has been focusing on improving operations rather than growing. Emphasis has been on containing costs, realigning the product mix, improving service, and increasing the average check, says president Vincent Liuzza. "Now we're ready to begin modest expansion."

The company has improved garnishes on all its platters, and is using sour cream on everything instead of charging extra. Shrimp fajitas, shrimp nachos, and chicken salad have been



With 2,712 units, Irvine, CA-based Taco Bell is the segment leader. Pictured: Taco Bell's MexiMelt.

added to the menu, and the dessert line has been broadened. Flan (a Mexican custard) is lower priced than Cuco's popular fried ice cream, and has helped improve the average check, which has risen from about \$8.25 to close to \$9.

The printed menu was redesigned to improve the product mix and to help improve the check average. The previous menu was a straightforward presentation, with no features. The new menu features those entrees that Cuco's prefers to sell, such as chimichangas.

The menu also highlights "Cuco's Difference," as Liuzza calls it, under the heading of "33 Reasons Why Cuco's is Better." The menu goes on to explain that Cuco's uses only fresh, high-quality ingredients such as ground sirloin in its food.

The future seems bright for the Mexican segment. Although the rate of sales and traffic may decline, overall increases should continue. Most chains and independents continue to prosper, even in the economically depressed and somewhat saturated Southwest. And for the venturesome companies that manage to penetrate the nearly virgin territories of the Northeast and Middle Atlantic states, the rewards are great. ▢

The upscale portion of the segment is dominated by independents attracting new customers who have graduated to authenticity.